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# **On the character of the EU and its budget;**

## **Look into the future**

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### **Abstract:**

The paper aspires to find the reasons for allegedly slow and inefficient decision-making in the EU and in doing so also tries to predict what the future challenges mean for the organisational structure of the EU. It argues that, due to asymmetric challenges, consensus should remain a European asset and that increased heterogeneity of preferences due to rising EU membership is in fact not the major culprit of inefficient decision-making. The paper shows that at least in the medium term the combination of another two factors should be blamed instead: firstly, the blurred division of responsibilities and secondly, the budgetary procedure, which gives incentives to the Member States to approve policies without (sufficient) value-added to the EU. The paper makes a concrete proposal how the budgetary process should be improved in order also to remedy the decision-making inefficiency problem.

**Keywords:** EU budget, EU decision-making, multi-level governance, public finance

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## **INTRODUCTION WITH THEORETICAL CONTEXT**

Has the enlarged European Union (EU hereafter) really lost its ability to function efficiently? What does the EU of 27 or even more mean for the ability to make decision and how should these be made? How can it happen that on such a fundamental issue as the budget, there is such a widespread agreement on its archaic structure, on which the Member States were unable to make any notice-worthy progress in spite of almost two years of negotiations?

Before the big enlargement of 2004 with 10 new Member States, there was great fear of possible blockage of the EU's decision-making process. Such bleak expectations were not just coming from politicians and practitioners, but also from research and academia, who used theory to back up their case. Namely, both approaches to decision-making in Europe, the rationalist and the constructivist, make the same prediction about the consequences of enlargement: due to the increase in the group size, decision-making in the EU would slow down. However, the causal mechanisms for such conclusion differ (Leuffen 2006).

The rationalist approach stresses the importance of formal rules, bargaining power and preferences of the actors and especially the latter should, as a consequence of enlargement, very likely become more heterogeneous (e.g. Baldwin et al. 1997, König and Bräuninger 2004, Zimmer et al. 2005). Since the growing heterogeneity of preferences would reduce the size of win-sets, enlargement should contribute to policy stability (Tsebelis 2002), increase the probability of gridlock and ultimately reduce the efficiency of decision-making in the EU. The same outcome in the rationalist tradition is also predicted by the arguments of increased "bargaining complexity" (e.g. Zimmer et al. 2005), transaction costs (e.g. Schimmelfennig and Sedelmeier 2002) and coordination and free-riding problems (e.g. Olson 1965, Mueller 2003). The constructivists on the other hand understand preferences not as exogenously given,

but rather as a result of social interaction, thus putting more focus on informal rules, norms, trust, common frames of reference and personal relations (e.g. Lewis 2003, Heisenberg 2004). Obviously, the norms, frames of reference, etc., can be reasonably expected to differ among the old and new Member States due to different historical and cultural backgrounds as well as traditions, socialisation patterns, which ultimately should increase the level of conflict and make finding consensus in larger groups harder. Contrary to rationalist logic, constructivists can account for medium-term convergence of social norms, thus also gradual improvement in decision-making efficiency.

These pessimistic predictions are hard to verify empirically, since the efficiency of decision-making in the EU should neither be measured on the basis of output quantity nor the time-efficiency of the decision-making process. Instead, the right variable to look at would be the quality of decision-making, which, of course, is notoriously hard to measure. It is for this reason that the growing body of literature accepts the second-best solution and makes conclusions on the basis of non-quality based indicators. One of the exceptions is the approach taken by Baldwin and Widgren 2007, who use the so called “revealed preference” reasoning to substantiate their argument on the necessity to reform the decision-making process in the EU. According to the authors, the EU leaders have the private information on the necessity of the decision-making reform, which can be objectively gauged by looking at the decisions that have been taken through time.

In this paper we argue that the approaches mentioned above, which usually make use of “before-after” quantitative research designs, are susceptible to overlooking the potentially crucial qualitative factors in the decision-making process, which have significant impact on its efficiency. That is not to say that the enlargement has had no impact on the efficiency of the

decision making, however, we would argue that this is not the crucial variable which influences the quality of the decision-making in the EU.

In order to do this we will first analyse the type of challenges the EU is faced with. The focus here will not be on identifying challenges per se, but rather to see to what extent they are asymmetric to different parts of the EU (chapter 2). The asymmetric shocks and challenges would have different consequences for the development and consequently on the optimal decision-making structure of the EU than in the case of symmetric ones. Asymmetric challenges have as a consequence greater sensitivity of different parts of the EU to particular policies that might be decided on the EU level. We then analyse the qualitative sources of the problems that the EU's decision-making is presently faced with in chapter three and make the proposition that in the context of asymmetric challenges, consensual or predominantly consensual decision-making is in fact an asset rather than liability. On this basis chapter four and five make recommendations about how the decision-making should be improved: in particular with regards to the division of responsibilities as well as the budgetary procedure. Especially the reformed budgetary procedure is of particular importance not just in terms of its symbolic value as to what the EU is all about, but is also at the heart of inefficient decision-making at least for the policies with financial consequences, i.e. the majority of them. We will show that the reformed budgetary procedure that we introduce, would give the right incentives to the Member States to adopt the needed policies for the EU, which in turn would also enable more optimal division of responsibilities and (more) efficient decision-making in general.

## **ASYMMETRIC CHALLENGES: INTERDEPENDENCE IN INEQUALITY**

From an economic point of view the EU's main value added is represented by the Single European Market, which should, on the basis of free movement of goods, services, capital and people, ensure strengthened competition, enable realisation of economies of scale and thus ultimately contribute to the welfare of EU citizens. Despite a major step forward in the abolishment of inter-state barriers, data still show that national borders still decisively determine the »geography« of mobility and business operations in Europe. For example, the effect of national borders on the propensity of people to move between two places reflects itself as an implicit increase in time distance of two hours, and in the case of impact of distance on economic growth, national borders represents a time-distance of 600 minutes (Cheshire and Magrini, 2006a, 2006b). Even if common market would be fully operational however, the location and initial conditions of particular areas of the EU would still matter, not least due to the proximity to economic mass effect (Rice, Venables and Patacchini 2005). Thus the location of a particular subject within the EU is all but irrelevant and will continue to be so even if / when the common market will be fully operational.

Last decade has also seen the introduction of the European Monetary Union (EMU hereafter), which adds to the transparency of market operations and thus intensified the competitive pressures in the entire Union. The increased transparency will contribute towards restructuring of the traditional patterns of business operations and create new added value on the EU level. However at the same time EMU can, on the basis of rigid production factor markets, also result in increased unemployment in case of asymmetric shocks due to the absence of an adaptable exchange rate. Labour mobility is particularly important in this regard because in economic areas with higher labour mobility like United States, the unemployment

rate, after internal or external asymmetric shock, rapidly returns to equilibrium. In low mobility areas like the EU, the unemployed leave the labour market, which results in lower unemployment but also lower employment rates of the affected areas (Braunerhjelm et al., 2000).

Globalisation represents the third asymmetric challenge to the Member States of the EU: the rise of new, rapidly growing economies from China, India and the entire south-east Asia to Latin America with Brazil in the lead. These countries are less and less competing on the basis of relative labour abundance, but are entering the markets with higher added value on the basis of larger input of knowledge instead. In the long run the rise of these economies presents an opportunity for the EU as their growth due to market creation effect positively contributes to the growth of the EU. On the other hand EU also faces the import substitution effect, with a number of EU countries also fearing the so called relocation of jobs to countries with a lower cost of labour. Taking into account the ever lower costs of trade, the pressure of competition on the EU will inevitably intensify, calling for an adequate response from the EU.

The common denominator of all these processes is that in the future the EU will still be faced with extensive restructuring processes, which will result, assuming positive scenario of strengthened comparative advantages, in a higher growth on the EU level, these advantages and benefits however, will in no way accrue automatically or in equal extent to all parts or areas within the EU. Apart from adaptability and specialization an ever more important role in economic efficiency is played by the agglomeration economies or (localised) externalities, economies of scale, learning curve, path dependence and alike, all increasing relative possibilities of the stronger and more developed areas, that can in perspective strengthen the tendency towards concentration of economic activity. At the same time it is also true that

there are forces favouring deconcentration as the effect of congestion caused by the immobility of production factors or “love-for-variety” effect - the question remains however, at what point these effects prevail. There is no consensus on the balance of these forces, however empirical studies point out that the factors contributing to the concentration, play at least an important if not a predominant role (e.g. Bonaccorsi and Daraio, 2007, Ciccone, 2002, Crescenci, 2005 and the like).

Thus, the EU is faced with profound asymmetric challenges calling for its dynamization if it wants to preserve competitiveness and economic activity on the European soil. To meet these goals joint actions exploiting economies of scale on the EU level are badly needed, which additionally substantiates the existence of the EU and its policies (e.g. R&D policy). In meeting these challenges it is all but self-evident however, that the advantages resulting from the aggregate growth will be evenly distributed to different areas/regions, which renders necessary a balanced policy-mix that ensures just distribution of benefits and costs among the Member States and the regions.

## **WHERE IS EU'S DECISION-MAKING “INEFFICIENCY” COMING FROM?**

The presented circumstances display that European countries need the Union, at the same time it is obvious however, that Member States have and will have, regardless of (in principle) common goals, rather divergent views on a number of policy dilemmas due to geographically asymmetric consequences of particular policies. This would be of smaller significance if the EU had a higher labour mobility, because mobility would balance out the benefits and costs to an individual. Furthermore, due to historical and cultural differences and traditions the

citizens primarily consider themselves as “citizens of the Member States” and will, at least in the medium term, continue to feel rather limited attachment to the EU. We should thus accept that due to the way we do business and especially because of the citizens’ differentiated preferences and perceptions, the EU at least for now does not operate as a unitary system and also will not operate as such in the near future. This makes it is hard to imagine the EU as »United states of Europe«, regardless of Schumann's vision from the 1950, on the foundation of a federal Europe and of an »ever closer union among the peoples of Europe«. Because of asymmetric results of particular policies for different areas, federalisation would lower the relative influence of each area on decision-making, meaning that federal organisation would very likely lead to serious internal conflicts. In the context of inter-governmental co-operation it is therefore the consensus that represents the central tenet of how EU operates; and this should be considered as a positive feature as it ensures cohesiveness of otherwise increasingly heterogeneous union. It is the consistency of the policy-mix that makes possible general agreement and a functioning Union: enabling introduction of policies that contribute to common public goods (security, human rights, foreign policy...), intensive development policies (Lisbon) and policies that ensure harmonious development and equal possibilities (cohesion). Of course, the enlargement might have an impact on the exact balance of policies, but it is through the additional benefits brought in by the enlarged market, growth, know-how, etc., that justify the change of the previous balance. Thus despite the strong critiques, balanced and consensual policies, represent an asset and a European value, which makes EU stronger, not weaker.

The problem arises, however, if the necessary decision-making is not fast enough to respond to the posed challenges or if some of the necessary decisions would not be taken at all. As far as the latter is concerned it is very hard to theoretically justify the concept of “necessary

decisions”. If a certain democratically elected government under assumption of equally efficient and informed governments as well as undistorted incentives in the decision-making process does not accept a certain policy then this simply cannot be argued to be the right policy for the (whole) EU. It might be very problematic however, if decisions are not taken fast enough, because fast reaction times in a global competition with other world regions is becoming more and more pertinent.

There seems to be more or less general public consensus that Europe cannot function effectively with increasing number of Member States. Baldwin and Widgren, 2007, argue for example that “there is no reason to believe, nor has there ever been, that the EU could enlarge from 12 to 27 members without streamlining its decision-making procedures”. Recent empirical research however does cast doubt on such a proposition. First there are reports by the European Commission, which claims that “institutions have continued to function and to take decisions” (European Commission 2006: 19). The more quantitative assessments can be found in Dehousse et al. 2006, who found not just that decision-making has not been blocked, but that in certain respects it was even expedited. In a similar vein Settembri reports that “after enlargement, the system delivers a comparable amount of acts; on average, it does so faster and without greater political contestation than before.” (Settembri 2007: 31). In terms of output quantity, Hagermann and De Clerck-Sachsse 2007, also report that “the period immediately following the enlargement saw a general drop in the amount of legislation passed, but the annual adoption rate had almost ‘recovered’ by year-end 2006” and also that “the level of disagreement recorded officially in voting has not increased since the enlargement” (Hagermann and De Clerck-Sachsse 2007: i). The “business as usual” conclusion seems to apply to the Council, the European Commission as well as to the European Parliament (Dehousse et al. 2006). It would be misleading to conclude however,

that nothing has changed. Settembri finds that although the overall number of bills passed has decreased only marginally the EU decides increasingly on marginal issues, the decision-making process has become more bureaucratised (Settembri 2007: 33), Hagermann and De Clerck-Sachsse 2007, “explain” significant part of the recovery by much more extensive use of qualified majority voting. Furthermore, in the increasingly applied co-decision procedures between the Council and the Parliament, the decision-making after enlargement is some 22% slower than with EU15 (Settembri 2007).

Thus the enlargement clearly has changed the balance of policies and to a certain extent also the way the EU does business. However, it can hardly be argued that due to greater number of Member States the EU needs to go in the direction of greater “federalisation”, because of its inability to decide fast enough. In fact Galub 2007 has shown that historically, enlargements have increased decision-making speed as has qualified majority voting. The latter has in 2006 cover already 53% of the legislation (Hagermann and De Clerck-Sachsse 2007), which means that the power of consensual approach within the framework of the EU was already weakened to a great extent. This has been not only to the benefit of faster decision-making but also to the benefit of increased power of »larger Member States« (Kauppi and Widgren 2006). Such trend can be to a certain extent justified, however, the EU should be careful not to neglect the importance of consensus in the Union since, as argued before, the EU needs to preserve the general balance and proper consensus on the policy mix taken.

Instead of moving away from consensual decision-making, the challenge of inefficient decision-making, as exemplified for example by the 2007-2013 financial perspective negotiations, should in our opinion not primarily be sought in rising EU membership. We would argue that the inability for certain EU reforms, comes from perverse incentives

Member States are faced with in the decision-making process, which actually promote inefficient »quid-pro-quo« attitude that encourages the Member States to follow their own partial interests. Secondly, it is within the framework of blurred division of competences among the EU and Member States that additionally stimulates the before mentioned “horse-trading”. Thus, the problem of the EU’s “inefficiency” in decision-making and consequently also in its modernization should in our opinion be looked for in the direction of the institutional and organizational reform of the EU through: (1) a clearer vertical division of competences based on the logic of public goods and on the principles of fiscal federalism, and (2) on a simultaneous reform of the budgetary procedures, which should ensure “balanced and justified financial burden” for all Member States, thus giving proper incentives for deciding on policies.

## **DIVISION OF RESPONSIBILITIES**

A more thorough analysis of the division of competences in the EU goes beyond the scope of this paper. In principle it does appear however, that the EU and especially the European Commission use a lot of energy and time on issues, which are not their (at least not direct) jurisdiction instead of focusing their attention (in terms of both human resources and in a political sense) on issues that were or should be transferred to the EU level. The European Commission is trying to expand the area of its operations, thus implicitly stimulating expectations by the »voters«, who rightly expect improvement in a given area in accordance with the given commitments. In dealing with these issues the chickens are often counted before they are hatched, because the instruments of decision-making and competences are simply not in the hands of the Commission or other European institutions. This reduces the transparency of the decision-making structures for the citizen also rendering the whole democratic structure of the EU less efficient.

There are quite a few such issues, e.g. the field of labour market liberalization and other structural reforms or the EU starting to get involved in the sphere of culture, sports and the like. More and more the so called principle of the open method of coordination is also being introduced at the EU level, where pressures »from above« are created to increase the implementation probability of particular policies also in cases where this is politically questionable or sensitive<sup>1</sup>. This is potentially quite a dangerous approach as in this way the boundary-line on the division of competencies becomes blurred, making it less clear who bears responsibility for particular (in)action. In this manner and despite the formal obligation, as defined in article 5 of the Treaty on the European Union, the subsidiarity principle, saying that given competences and duties should be performed on a higher level only in cases where they cannot be carried out equally efficient on a lower level, can be easily ignored. Decision-making closer to the people or more specifically, on a level where benefits and costs arise, means that because of better information and better transparency, more optimal decisions will be made. This approach also promotes innovation, while centralization often leads to »one-size-fits-all« solutions for everyone, again affecting asymmetrically different parts of Europe.

On the other hand certain procedures within the framework of delegated competences are already needlessly complicated, resulting in the reduction of potentially positive effects to the EU. Thus for example, the European Commission rightfully has full authority in the field of competition policy for cartel agreements and mergers obstructing free competition on the Single European Market, while on the other hand the Commission still lacks full authority in the field of anti-dumping measures, where each final decision must be ratified by the Council of Ministers, thus only broadening the possibility of decision-making based on »uneconomic principles«. There are also activity fields where the EU level still has no jurisdiction, but

would be fully justified to – from the Community Patent system to the extreme issues such as defence.

Thus, as shown with examples above, the EU is increasingly taking decisions on issues where no EU involvement is justified - taking into account the theories of public goods and fiscal federalism. Furthermore, increasing use of softer coordination mechanisms reduces transparency of the decision-making process, which makes good breeding ground for “horse-trading”. In other words, there is less need for decision-making as it would appear at a first glance. There are, on the other hand, issues which should be dealt with on the EU level, but are not. The inability to decide in such circumstances is in our opinion importantly conditioned by perverse incentives for the Member States.

## **DISTORTED (FINANCIAL) INCENTIVES**

Majority of decisions have financial consequences, which means that without the incentive structure that would ensure approval of the policies on the basis of their merit and value added the EU also cannot have efficient decision-making system. This unfortunately is not the case in the EU where primary objective of the budget negotiations as well as debate on a particular policy with financial consequences is in fact determined by the policies’ impact on the net financial position of a country in question. Thus in deciding whether to support particular policy or not, the Member States does not weigh the pros and cons of the policy and its value added, instead they simply calculate whether this policy will bring more money in the country in question than it will need to pay for it.

The consequence of such an approach is the existence of policies which improve the net financial position of a single (group of) Member State(s) but bring no added value to the

Union at large, i.e. their implementation through the EU results in an overall net loss for the Member States (as well as the EU). This kind of logic means an essentially bigger volume of the previously mentioned »quid-pro-quo« bargaining among the Member States, as they are all but forced to do it since every country needs to benefit at least from some policies. Eventually, this means that the policy-balance in the present decision-making context is not determined by the merit of the policies but by the Member States' net financial positions, which makes negotiations much more complex and notoriously inefficient. In order to break away from such perverse incentive structure the redistributive and allocative elements of the budget should be separated (Begg and Heinemann 2006) the question is how.

### **What has been proposed already?**

One strand of solutions is argued to be found in the direction of renationalisation of EU policies with clear national or regional benefits or in the direction of strengthened decision-making power by institutions with overarching European interest, i.e. especially the Parliament or the Commission (e.g. Heinemann 2005, Gross and Micossi 2005). As far as the former proposal is concerned such a solution is clearly the first best for those policies, which should not be implemented at the EU level in the first place, while for the others, such a solution could entail an efficiency loss for the Union (e.g. due to lessened competition). The problem with the latter however is that it is only feasible in the longer run as those institutions themselves, at least for now, also have inherent bias towards national interests or "a priore" bias towards strengthening of the EU level. A more shorter term solution can on the other hand be found in the work of De la Fuente and Domenech, 2001, Begg and Heinemann 2006 and Heinemann 2007, which also represent the basis of our proposal. De la Fuente and Domenech put forward an overall redistribution parameter, which reflects the »relative net per capita transfer from the EU expressed as a fraction of the real income differential with the EU

average in a typical member state« (De la Fuente and Domenech, 2001: 6) and is subsequently used in the general correction mechanism. Their proposal can be summarised as follows (De la Fuente and Domenech, 2001: 13, 16 and 17):

*“First, an agreement should be reached on the level of expenditure that will be required to meet EU policy objectives, on the regular mechanisms for its financing and on the desired degree of redistribution. Given this agreement, indicative net balances should be computed for each of the member states on the basis of their per capita incomes and an agreed-upon redistribution coefficient. Second, budget allocations to specific expenditure programs should be made on the basis of the relevant policy objectives, without regard for their impact on country net balances. Finally, structural spending and, if necessary, compensatory payments or rebates should be set so as to obtain the desired redistributive outcome, given the distribution of other expenditure items. The procedure will probably work best if it is applied in an incremental way, i.e. as a tool for identifying the desired direction of change from the status quo.”*

In order to do implement this proposal all EU expenditures would need to be allocated among member states for which they propose different allocation keys (GNP for overheads, location of EU institutions for operating expenses, production of relevant agricultural markets for allocation of export rebates and price support interventions etc. The proposal by De la Fuente in Domenech, provides an answer to the wrong incentive mechanism for the Member States in the budgetary negotiations, however, is at the same time faced with three problems or disadvantages itself. Firstly, the proposed calculation of redistribution coefficient and thus necessary complete ex-ante allocation of expenditures per Member States is relatively complicated, while at the same the redistribution coefficient itself does not provide simple enough intuitive logic for the political level. Secondly, the redistribution coefficient by

definition implies income per capita and the foreseen “fair” distribution function as fixed and only possible, which reduces the sometimes necessary flexibility in the budgetary negotiations. Objectivity can surely be considered as a positive feature of the proposal however, it can reduce the chances of its application in practice. Finally, the proposal by De la Fuente and Domenech, requires the overall size of the budget to be determined in the beginning of the process, which by definition requires “top-down” approach. That is to say, the best way to justify the size of the budget in our opinion is on the basis of justifiable policies and their impacts, not by the size of the budget per se. Such an approach would in practice require discussion on the policies already in the first step, which would to a certain extent eradicate the positive properties of the reformed budgetary procedure.

Our proposal improves the above mentioned proposal, by making it simpler as well as more flexible. Our proposal additionally makes use of the proposition by Begg 2005, Begg and Heinemann 2006 and Heinemann 2007 that the redistributive and allocative elements of the budget should be separated on the basis of the horizontal cash transfers and splitting of the budget in two parts. By joining of the two concepts and concretising the procedures and institutional responsibilities, we hope that our proposal should hopefully add up to politically more feasible reform that could be considered for the Agenda 2014 debate.

## **Budgetary reform: an improvement**

### *Part A: European public goods budget*

Our proposal starts with Heinemann's proposition that expenditure that could be classified as European public good, should be treated separately. The rationale for such a proposition is that by definition, the benefits of these expenditures cannot be attributed to particular Member States therefore rendering them completely incompatible with the notion of net financial balance per Member State.

In the 2007-2013 financial perspective this part of the budget would broadly refer to the following issues or chapters:

- Globalisation Adjustment Fund from chapter 1a
- 3a: Freedom, Security and Justice
- Solidarity Fund in the framework of heading 3b (Citizenship)
- 4: EU as a global player
- 5 Administration

For this part of the budget the necessary extent of resources would be determined separately, while financing would be provided on the basis of countries' share in the EU's GNI. These contributions would of course not be included in the calculation of net budgetary balances as this cannot be justified or interpreted in any meaningful way. For the Solidarity and Globalisation fund it is the rationale and by definition unpredictable nature of their mission that makes them both inappropriate as well as impossible to be included in ex-ante calculation of net budgetary positions.

### *Part B: Expenditures with localised benefits*

This part of the reformed budgetary procedure would determine the other headings of the budget, which however can be classified into two groups:

- Group 1 would refer to present headings 1b (Cohesion for Growth and Employment) and 2 (Preservation and Management of Natural Resources), whose allocation per Member States already represents part of the financial perspective negotiations simply because they are awarded on the basis of national envelopes.
- Group 2 would refer to present headings 1a (Competitiveness for Growth and Employment) and 3b (Citizenship apart from solidarity fund), which are predominantly disbursed on the basis of calls for projects, thus on the principle of excellence and whose allocation per Member States can only be determined ex-post.

Group 2 in particular needs additional clarification as contrary to the European public goods expenditures, the benefits of these expenditures can be localised, which is not true for the public goods. Main feature and quality of this group of expenditures is the principle of competition, which directly enhances the impact of public expenditures and therefore also brings value added to the Union as a whole. Nevertheless, due to asymmetric absorption capacity of different Member States and regions, it is not possible to ignore that due to localisation of benefits less “able” Member States will have disincentive to support such policies, since in terms of their net financial position (and direct economic benefits) they will be disadvantaged. These benefits should therefore be taken into account in determining net financial burden of the EU budget that each Member States will bear.

### *Budgetary procedure*

For part A of the budget, the European value added expenditures, there are no pressing reasons for modifications of the budgetary procedure, which means that also in institutional sense, the budget could be approved according to the current practice. Thus the European Commission would prepare the proposed size of the budget by heading, which would be subsequently submitted either to the Council or to the European Parliament (as foreseen in the reform Treaty) and then finalised in the interinstitutional agreement.

It is the B part of the budget whose budgetary procedure needs significant overhaul. In the first step the net payers and net recipients would decide the absolute amount of redistribution per Member States, thus determining the target (and final) net financial positions of the Member States (excluding of course part A of the budget). In determining the extent of redistribution the fairness principle should be taken into account, which basically means that more developed Member States should contribute more to the EU budget (cohesion objective). Even though the development level of the Member State presents itself as an obvious objective criteria to use for determining the extent of redistribution, it should be pointed out, that according to this proposal one must not necessarily strictly follow whatever function or indicator (GNIpc,...) it feels best complies with the fairness principle as long as redistribution is budgetary neutral - in other words, that net financial transfers are equal to zero. Such departures from the objective criteria could potentially be justified on the basis of catastrophic natural disaster of greater proportions with multi-annual financial consequences, which could render justified smaller net contribution by the affected Member State. In any case, such flexibility, if used wisely, can greatly improve the political acceptability of the proposal, because it makes is very simple for the politicians to find consensus.

In institutional sense the proposal on the extent of redistribution would be prepared by the European Commission and would be approved by the European Council after consultation with the European Parliament or in line with the new Treaty, would be first sent to the Parliament and only then to the Council. Because the EU budget is still predominantly financed from the Member States' contributions it seems, from theoretical point of view, more justified that Council would continue to play a dominant role in this part of the budget preparation.

In the second step the European Commission would prepare the proposal on the scope and content of particular policies, which should in any case be first sent to the European Parliament and only then to the European Council, because at this stage, the net financial position of particular Member States had already been ensured. This gives relative priority to the “contents”, to policies at the expense of the size of the budget, justifying greater direct involvement of European institutions. In terms of timing the optimal solution would be that the European Parliament would send both A and B parts of the budget to the Council at the same time.

Apart from formulating the proposal on the EU policies, the European Commission would also need to prepare the “ex-ante allocation of expenditures” by Member State, which would allow the calculation of “spontaneous net financial balances” in B part of the budget. For the group 1 expenditures (cohesion, agriculture), this can be derived directly from the policy proposals already, while for the group 2 expenditures (competitiveness,...) the Commission should take into account average absorption rate of the Member State in the previous financial perspective<sup>2</sup>. During the implementation of the financial perspective particular Member States can be more or less successful than assumed during the negotiation, this however would not

affect their contribution to the EU budget, which in turn would retain their incentive to be as active and successful in competing for this part of the resources, thus completely preserving the competition principle. On the other hand, making use of the absorption rate in the previous financial perspective would in the long run still represent at least some sort of “security net” for contributions of the “less competitive”, thus also politically more acceptable.

With the above decisions made it would be possible, in the third step, to calculate the extent of contribution in the EU budget by Member State, which equals the ex-ante allocation of expenditures to particular Member State increased / reduced for the target net financial position (extent of redistribution) as agreed and approved in step one.

The table below presents a stylized example of the proposed system on the basis of two policies for three Member States’ Union: let’s assume that the Commission, Parliament and the Council would agree on two policies, with the ex-ante allocation per Member States as presented in the first two rows. In order to calculate the contributions, all that is needed is to subtract the agreed extent of transfers as decided in step one (presented for two cases reflecting different extent of redistribution: 2.1 and 2.2.) from the total allocation per Member States.

| <b>Member State:</b>  | <b>»Recipient«</b> | <b>»Average«</b> | <b>»Developed«</b> |
|---|--------------------|------------------|--------------------|
| Policy X allocation per MS - €billion   | 2                  | 3                | 5                  |
| Policy Y allocation per MS - €billion   | 9                  | 1                | 0                  |
| <b>(1) Total allocation per MS - €billion</b>                                 | 11                 | 4                | 5                  |
| <u>(2.1) CASE 1:</u> Absolute transfer size as decided in step one - €billion | + 1                | 0                | -1                 |
| <b>CASE 1: Contribution by MS - €billion</b><br>= (1) - (2)                   | <b>10</b>          | <b>4</b>         | <b>6</b>           |
| <u>(2.2) CASE 2:</u> Absolute transfer size as decided in step one - €billion | + 3                | 0                | -3                 |
| <b>CASE 2: Contribution by MS - €billion</b><br>= (1) - (2)                   | <b>8</b>           | <b>4</b>         | <b>8</b>           |

*Value added of the improved proposal*

The improved proposal gives a simple and flexible method to the Member States to agree on their net financial positions to the EU budget, because it is not based on a formula and does not require the allocation of all expenditures by Member States. This makes it possible to put the size of the budget and net financial position out of the spotlight and to put focus on the policies that the EU should pursue thus significantly improving the quality (and consequently also efficiency) of EU's decision making. This means, that the size of the budget can be determined as a result of agreement on policies (step 2) instead of vice versa, which means that effectively, the budget would be rather prepared on predominantly bottom-up logic. Proposal also includes an incentive mechanism that would preserve the competition principle also in B part of the budget, promoting better use of the EU resources. Finally, the proposal takes those expenditures that represent a European public good (these are identified) out of net financial positions debate, which would make the budgetary procedure not just simpler but also more objective.

## CONCLUSION

The paper analyses the decision-making efficiency of the EU, giving particular attention to the consequences of the rising number of Member States and the alleged inability of the EU to respond to new challenges. The heterogeneity of preferences due to enlargement is often cited as an argument for strengthened “federalisation” of the EU either in the direction of a significantly expanded majority voting or stronger political integration “proper”. We have argued that the quantitative research usually used to analyse this topic is susceptible of missing out potentially crucial qualitative factors that have much stronger impact on the efficiency of the decision-making in the EU than the “before-after” quantitative research designs.

We have pointed out that a number of challenges confronting the EU have asymmetric consequences for different parts of the Union, which in spite of the need for common response will still necessitate generally balanced policy-mix. Thus contrary to the predominant view we argue that consensus is an asset and quality of the European decision-making, which should be cherished and preserved at least in the medium term. We have furthermore established that time-efficiency of the decision-making in the enlarged Union has in fact not diminished, although it has changed in qualitative terms. Increased heterogeneity of preferences due to enlargement has certainly contributed to this, we argue however, that there are two other mechanisms at work that contribute more strongly to the inefficient “horse-trading” in the EU. The first is the suboptimal and blurred division of responsibilities where on the one hand EU is increasingly taking decisions on issues where no EU involvement is justified, while also introducing “coordination” mechanisms that reduce the transparency of the decision-making. The second inefficiency mechanism refers to policies that are or should be implemented on the EU level. In deciding on those the Member States have distorted

(financial) incentives the consequence of which is that policy-balance is not determined by the merit of the policies but by the Member States' net financial positions, which makes decision-making much more complex and notoriously inefficient.

By making use of the contributions of De la Fuente and Domenech, 2001, Begg 2005, Begg and Heinemann 2006 and Heinemann 2007, the paper puts forward a concrete and workable proposal how the misgivings of the present budgetary and consequently decision-making procedure could be improved. The proposal simplifies the reform, makes the budgetary process more flexible for the decision makers and thus hopefully also makes it politically more feasible. Furthermore, it gives greater stress to the bottom-up principle and at the same time establishes the right incentive mechanism for the Member States that should not just empower the EU to finance more of the "right policies", but also enable it to optimise the division of responsibilities between the EU and the Member States, thus also enabling more efficient decision-making in general.

Reforms above clearly do not represent an exhaustive list of the possible measures for improved decision-making. We do believe however, that such a change would re-orient the focus of the decision-making onto the relevant issues and thus improve its efficiency much more than by moving away from the consensual decision-making. Furthermore, this example also shows that it is the qualitative and not quantitative factors that should be put to the fore when discussing decision-making efficiency of the EU.

## NOTES

- 1 The implicit assumption is that on the EU level long-term policies can be introduced, while single Member States on their own would not be able to take such decisions. This could be described as »paternalist argument«, which has a rather fragile theoretical foundation. In practise though, there might be circumstances and / or policy areas, where open method of coordination could have some positive (but also negative) consequences.
- 2 For those Member States that past performance is unavailable or is not comparable for any other reason (e.g. in case of enlargement), the Commission would calculate the expected allocation on the basis of simple regression equation explaining the allocation with variables like GDP pc, number of researchers, etc.

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